

COMMONWEALTH OF PENNSYLVANIA



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March 11, 2014

Rosemary Chiavetta, Secretary  
PA Public Utility Commission  
Commonwealth Keystone Bldg.  
400 North Street  
Harrisburg, PA 17120

Re: Petition of Little Washington Wastewater Company  
for Approval of a Distribution System Improvement Charge  
Docket No. P-2013-2366873

Dear Secretary Chiavetta:

Attached for electronic filing is the Main Brief of the Office of Consumer Advocate in the above-referenced proceeding.

Copies of this document have been served per the Certificate of Service.

Respectfully submitted,

A handwritten signature in cursive script that reads "Erin L. Gannon".

Erin L. Gannon  
Assistant Consumer Advocate  
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Attachment

cc: Honorable Susan D. Colwell  
Certificate of Service

177236.doc

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Little Washington Wastewater Co. :  
For Approval of a Distribution System : Docket Nos. P-2013-2366873  
Improvement Charge : C-2013-2369886

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MAIN BRIEF OF THE OFFICE  
OF CONSUMER ADVOCATE

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## I. STATEMENT OF THE CASE

The Office of Consumer Advocate (OCA) submits this Main Brief pursuant to the Procedural Order of Administrative Law Judge Susan D. Colwell (ALJ Colwell) issued October 8, 2013.

### A. Background.

On February 14, 2012, Governor Corbett signed Act 11 of 2012 (Act 11 or Act) into law. Act 11 amends, *inter alia*, Chapter 13 of the Public Utility Code to permit water and wastewater utilities, electric distribution companies (EDCs), natural gas distribution companies (NGDCs) and city natural gas operations to petition the Pennsylvania Public Utility Commission (Commission) for implementation of a Distribution System Improvement Charge (DSIC). See 66 Pa. C.S. §§ 1350-1360. See also In re: Implementation of Act 11 of 2012, Docket No. M-2012-2293611, Final Implementation Order (Aug. 2, 2012) (Final Implementation Order). Act 11 states that a DSIC is intended to provide for “timely recovery of the reasonable and prudent costs incurred to repair, improve or replace eligible property in order to ensure and maintain adequate, efficient, safe, reliable and reasonable service.” 66 Pa. C.S. § 1353.

In order to implement a DSIC, a utility must submit the following to the Commission: (1) an initial tariff; (2) evidence demonstrating that a DSIC is in the public interest and will facilitate the utility’s compliance with the Public Utility Code, Commission orders and regulations and other State and Federal requirements; (3) a Long-Term Infrastructure Improvement Plan (LTIIP); (4) certification that a base rate case has been filed within the previous five years; and (5) any other information required by the Commission. 66 Pa. C.S. § 1353(b). The Act provides that the Commission “shall, after notice and opportunity to be heard, approve, modify or reject the [DSIC] and initial tariff.” 66 Pa. C.S. § 1355.

The DSIC must be calculated to recover the fixed cost of eligible utility property and shall consist of depreciation and pretax return. 66 Pa. C.S. § 1357(a). Eligible utility property is property that has (1) not been previously reflected in rate base and (2) been placed in service during the three-month period ending one month prior to the effective date of the DSIC. Id. The DSIC must be updated quarterly. 66 Pa. C.S. § 1357(a)(2). A utility must file supporting data for each quarterly update with the Commission at least ten days prior to the effective date of the update and serve a copy on the OCA and the Office of Small Business Advocate (OSBA). 66 Pa. C.S. § 1357(d)(3).

Act 11 provides certain limitations on the utilities with regard to the implementation of a DSIC. See 66 Pa. C.S. § 1358. Specifically, a DSIC initially may not exceed 5% of the distribution rates of EDCs, NGDCs or city natural gas operations. 66 Pa. C.S. § 1358(a)(1). Further, a DSIC shall be reset to zero, *inter alia*, (1) upon the effective date of new base rates and (2) if, in any quarter, the data filed with the Commission shows that the utility will earn a rate of return that would exceed the allowable rate of return used to calculate its fixed costs under its DSIC. 66 Pa. C.S. § 1358(b). Additionally, Act 11 sets out specific audit and reconciliation procedures, including that any over-collections of eligible costs through the DSIC must be refunded to customers with interest. See 66 Pa. C.S. § 1358(e).

The Act requires the Commission to prescribe by regulation or order specific procedures to be followed to approve a DSIC. 66 Pa. C.S. § 1358(d); see also Final Implementation Order. In the Final Implementation Order, the Commission set forth specific customer notice requirements regarding the filing of a DSIC petition, the Commission's disposition of a DSIC petition and quarterly updates to the DSIC rate. See Final Implementation Order at 26. The Commission also clarified certain of the Act's provisions, including that, for companies using the

Commission's quarterly earnings report in determining whether a DSIC must be reset to zero, the cap shall be aligned to the "Adjusted Results" column in the report. Id. at 42-43. Attached to the Final Implementation Order is a model DSIC tariff.

B. Procedural History.

On May 31, 2013, Little Washington Wastewater Company (LWWC or Company) filed a Long Term Infrastructure Improvement Plan (LTIIIP) pursuant to Section 1352 of the Public Utility Code, 66 Pa. C.S. § 1352. On the same date, pursuant to Section 1353, LWWC filed a Petition for Approval of a Distribution System Improvement Charge (Petition). 66 Pa. C.S. § 1353. On June 20, 2013, the OCA filed Comments to the LTIIIP and an Answer, Notice of Intervention, Formal Complaint and Public Statement in response to the Petition. On July 19, 2013, Arnold M. Kring filed a Formal Complaint against the proposed DSIC rate, which was docketed at C-2013-2375151.

On September 12, 2013, the Commission entered an Order approving the Company's LTIIIP and approving LWWC's proposed DSIC, subject to recoupment and/or refund pending final resolution of certain issues raised in the Petition and Answer. In its Order, the Commission also directed that the following issues be assigned to the OALJ for hearing and preparation of a Recommended Decision:

1. Impact of accumulated deferred income taxes associated with DSIC investments and
2. Calculation of the state income tax component of the DSIC revenue requirement.

The September 12, 2013 Order did not address the OCA's pending Formal Complaint at Docket No. C-2013-2369886. The Order dismissed the Formal Complaint of Arnold M. Kring.

On September 16, 2013, the parties were advised that the proceeding had been assigned to ALJ Colwell and that a Prehearing Conference was scheduled for October 8, 2013. On

September 23, 2013, LWWC submitted a compliance filing establishing a DSIC rate of 0.00% effective for bills rendered on or after October 1, 2013. LWWC Tariff Supp. No. 85, effective Oct. 1, 2013. A Prehearing Conference was convened on October 8, 2013. During that conference, ALJ Colwell determined that any matters raised in the OCA's Formal Complaint and, specifically, issues regarding the application of the DSIC to contract customers, may be addressed by the parties. Tr. 12-14. In her Procedural Order issued October 8, 2013, ALJ Colwell, *inter alia*, memorialized the litigation schedule agreed to by the parties and consolidated the Complaint filed by the OCA with both petitions filed at Docket No. P-2013-2366873. On October 11, 2013, the Company filed a Revised Supplement No. 85, effective October 1, 2013, which corrected omissions in the compliance filing. LWWC St. 1S, App. A.

Pursuant to the established litigation schedule in this matter, the OCA served the Direct and Surrebuttal Testimonies of Thomas S. Catlin.<sup>1</sup> On February 7, 2014, the parties informed ALJ Colwell that both parties had agreed to waive cross examination of all witnesses at the hearings. The Testimonies of the OCA and the Company were moved into the record at the hearing on February 11, 2014. The OCA now provides this Main Brief in accordance with ALJ Colwell's Scheduling Order of October 8, 2013. The OCA's Proposed Findings of Fact, Conclusions of Law and Ordering Paragraphs are attached hereto as Appendix A.<sup>2</sup>

Simultaneous with the submission of Main Briefs, the OCA and LWWC will submit a proposed Joint Stipulation Clarifying Testimony and Resolving Contract Customer Issue.

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<sup>1</sup> Mr. Catlin is a principal of Exeter Associates, Inc., a firm specializing in public utility issues. Mr. Catlin earned a Bachelor of Science degree in physics and math from the State University of New York at Stony Brook in 1974 and a Master of Science degree in water resources engineering and management from Arizona State University in 1974. Mr. Catlin's work at Exeter involves review and analysis of utility rate filings, utility affiliate relations, alternative regulatory mechanisms and regulatory restructuring issues. Mr. Catlin's education and experience is set forth in more detail in OCA Statement 1, pages 1-3.

<sup>2</sup> Appendix B to this Main Brief contains a list of the testimony and exhibits sponsored by the OCA and admitted into the record of this proceeding.

## II. LEGAL STANDARD

LWWC bears the burden of proof to establish the justness and reasonableness of every element of its proposed Distribution System Improvement Charge. As set forth in Section 315(a) of the Public Utility Code:

Reasonableness of rates- In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceedings upon the complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. § 315(a). The Commonwealth Court interprets this principle as follows:

Section 315(a) of the Public Utility Code, 66 Pa. C.S. § 315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial. [Citations omitted.]

Lower Frederick Twp. v. Pa. PUC, 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980); see also Brockway Glass v. Pa. PUC, 63 Pa. Commw. 238, 437 A.2d 1067 (1981).

The Pennsylvania Supreme Court has stated that the party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. Even where a party has established a prima facie case, the party with the burden of proof must establish that “the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary.” Burleson v. Pa. PUC, 461 A. 2d 1234, 1236 (Pa. 1983) (Burleson). Thus, a utility has an affirmative burden to establish the justness and reasonableness of every component of its rate request.

The OCA points out that Pennsylvania law is clear that there is no similar burden for a party proposing an adjustment to a utility rate filing. See, e.g. Berner v. Pa. PUC, 383 Pa. 622, 116 A. 2d 738 (1955) (Berner). In Berner, the Pennsylvania Supreme Court stated:

[T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden, is by statute, on the utility to demonstrate the reasonable necessity and cost of the installations and that is the burden which the utility patently failed to carry.

Berner, 382 Pa. at 631, 116 A.2d at 744. The Commission recognizes this standard in its rate determinations. Pa. PUC v. Equitable Gas Co., 57 Pa. PUC 423, 471 (1983). See also University of Pa. v. Pa. PUC, 86 Pa. Commw. 410, 485 A.2d 1217 (1984). Thus, it is unnecessary for the OCA (or any challenger) to prove that LWWC's proposed rate is unjust, unreasonable, or not in the public interest. To prevail in its challenge, Pennsylvania law requires only that the OCA show how LWWC failed to meet its burden of proof.

In conclusion, LWWC must affirmatively demonstrate the reasonableness of every element of its proposed DSIC calculation and demonstrate that its proposed rate is just, reasonable, and in the public interest. The OCA will show that LWWC has failed to satisfy its statutory burden in the manner set forth below.

### III. SUMMARY OF ARGUMENT

In 2012, the General Assembly amended Chapter 13 of the Public Utility Code to permit wastewater utilities, electric distribution companies, natural gas distribution companies and city natural gas operations to implement a DSIC. See 66 Pa. C.S. § 1350 *et seq.* The issue in this proceeding is how the DSIC rate should be calculated to meet the requirements of Act 11 and the mandate of Chapter 13 that all rates be just and reasonable, consistent with all applicable laws and ratemaking principles. 66 Pa. C.S. §§ 1301, 1350-1360. The particular concerns raised by the OCA and addressed in this Brief, are that the DSIC rate should not be calculated to recover: (1) a return on dollars that were not invested by shareholders and (2) state taxes that were not paid by the utility. OCA St. 1 at 4-10. The premise underlying each is that when a utility receives tax benefits, those benefits accrue to the ratepayers by reducing the revenue requirement that rates are calculated to recover. Id.

LWWC proposes that the DSIC revenue requirement should be calculated as if those tax benefits do not exist. LWWC St. 1R at 2-5; OCA St. 1-S at 2-3. Instead, the OCA submits that if a utility enjoys the privilege of establishing a surcharge rate to recover plant investment without filing a base rate case, the tax benefits associated with that plant investment must also be reflected in the surcharge rate. OCA St. 1 at 4-8; OCA St. 1-S at 2-3. As discussed herein, this is consistent with the existing jurisprudence of Chapter 13, in which Act 11 was established. Nothing within Act 11 expressly provides otherwise. See, e.g., 1 Pa. C.S. § 1932 (the rules of statutory construction provide that statutes are to be constructed in harmony with existing law and as part of a general and uniform system of jurisprudence); Popowsky v. Pa. PUC, 869 A.2d 1144, 1159 (Pa. Commw. Ct. 2005) (Popowsky 2005) (all provisions of the Code that relate to ratemaking must be read together). See also Erie Sch. Dist. Appeal, 39 A.2d 271, 155 Pa. Super.

564 (1944); Northern Tier Solid Waste Auth. v. Dep't. of Revenue, 860 A.2d 1173 (2004) (Northern Tier).

The express language of the statute limits DSIC recovery to costs incurred by utilities. 66 Pa. C.S. §§ 1351, 1353. Federal income tax benefits associated with DSIC plant investment generate zero-cost funds that partially pay for that plant investment, *i.e.*, not all of the plant investment must be financed or paid for by shareholders. OCA St. 1 at 4-5. State income tax benefits associated with DSIC plant investment reduce the Company's taxable income, so the Company does not incur state taxes at the full statutory rate. Id. at 6-7. The DSIC calculation must reflect the tax benefits associated with DSIC investment or the rate will recover costs not incurred by the Company, in violation of Act 11 and the requirement that rates be just and reasonable.

#### IV. ARGUMENT

##### A. Accumulated Deferred Income Taxes.

##### 1. Introduction.

The Commission allowed LWWC's Act 11 DSIC tariff to go into effect on October 1, 2013, subject to resolution of the issues raised in the present litigation. LWWC's tariff provides that the rate base upon which the Company is allowed to earn a return is equal to the balance of DSIC-eligible plant less the accumulated depreciation on that plant. The rate base formula does not deduct ADIT associated with DSIC-eligible plant as a rate base offset. OCA St. 1 at 4, 6. ADIT is generated by the difference between the federal taxes actually paid by the Company and the federal taxes it records for ratemaking. OCA St. 1 at 4-5. ADIT is the cumulative balance of the deferred taxes generated over time, and it represents a zero-cost source of capital for the Company. By not deducting the applicable ADIT, LWWC's formula assumes that all of the plant was paid for with investor supplied capital when it was partially paid for with zero cost capital in the form of deferred taxes. *Id.* at 4-6. The resulting DSIC requirement will, therefore, include a return as if there were no zero-cost capital.

LWWC has offered no evidence or argument to refute the conclusion that the failure to recognize ADIT can overstate the investment balance and allow the Company to earn a return on funds that were not supplied by investors. Instead, LWWC's arguments against recognizing ADIT associated with the DSIC-plant investment are that it is too complex, the earnings cap is sufficient protection for ratepayers and the ADIT offset was not adopted by the Commission in prior orders or its model tariff. LWWC St. 1R at 3-4; LWWC St. 1REJ at 2-3.

The OCA will rebut each of these arguments below. The bottom line, however, is that the rates charged to LWWC's customers must be calculated correctly -- whether they are base rates or surcharge rates. It is not just and reasonable for a utility to earn a return on dollars that

its shareholders did not invest. In order to limit recovery to costs incurred by the Company, LWWC's DSIC tariff should be modified to read:

DSI = Original cost of eligible distribution system improvement projects net of accumulated depreciation *and accumulated deferred income taxes.*

OCA St. 1 at 6 (emphasis in original indicates new language).

2. ADIT Must Be Included in the DSIC Formula to Ensure that Rates Are Just and Reasonable.

As provided in its proposed tariff, LWWC's surcharge is intended to allow the utility to recover a pre-tax return rate applicable to the original cost of eligible projects net of accrued depreciation. LWWC Tariff Supp. No. 85, effective Oct. 1, 2013. LWWC St. 1S, App. A (Revised Tariff Supp. 85) at 10DSIC2. Specifically, every dollar of equity return in the DSIC is "grossed up" to include federal and state income taxes at the full statutory state and federal income tax rates. *Id.* LWWC is not actually paying that level of taxes to the government, however. LWWC is allowed to take deductions for accelerated and bonus depreciation that significantly reduce the income on which it must pay income taxes. OCA St. 1 at 4-6. The Internal Revenue Code prohibits LWWC from flowing through those tax reductions in rates on a current basis. OCA St. 1 at 4; I.R.C. §§ 167, 168. OCA witness Catlin explained how this law creates ADIT:

Accumulated deferred income taxes arise because certain income tax deductions such as accelerated tax depreciation and bonus tax depreciation must be normalized under the provisions of the United States Internal Revenue Code. That is, utilities such as LWWC are allowed to take tax deductions for accelerated and bonus depreciation that significantly reduce the income on which they must pay income taxes. However, under the normalization provisions of the Internal Revenue Code, those tax reductions are not allowed to be flowed through in rates on a current basis. Instead, income taxes for ratemaking purposes are calculated using book depreciation instead of tax depreciation as a deduction. The resulting difference between the taxes actually paid (taking into account accelerated and bonus depreciation) and the income taxes for ratemaking (taking into account book depreciation) generates what is known as deferred income taxes. ADIT is simply the cumulative balance of the deferred taxes generated over time. ADIT

represents a source of zero cost capital because the utility has paid less in taxes to the federal government than it has collected in rates. Under standard ratemaking practice, the balance of ADIT is recognized as a source of zero cost capital, as it is in Pennsylvania and most other states, or included in capital structure with a zero cost.

OCA St. 1 at 4-5.

As Mr. Catlin explained, under standard ratemaking procedure, as practiced in Pennsylvania and every other state and federal regulatory jurisdiction in the country, the balance of deferred federal taxes is treated as a reduction in the utility's rate base or included in capital structure with a zero cost, so that customers do not pay a return on non-investor supplied capital.

Id. In the general ratemaking context, this issue has been addressed repeatedly and consistently.

As stated in a leading utility treatise:

Most regulatory commissions have treated accumulated income tax deferrals as a cost-free source of funds. It must be kept in mind that, for cost-of-service purposes, current and deferred federal income taxes are treated as part of the revenue requirements calculation. However, the accumulated deferred income taxes are then used to reduce rate base, to produce a cost-free source of funds to the utility ratepayer.

Robert L. Hahne, Gregory E. Aliff, Accounting for Public Utilities, § 3.02 (2) (1983). This principle is stated even more succinctly in Bonbright's Principles of Utility Rates, which states:

We never have seen a plausible defense for a claim to the enjoyment of a profit on funds not contributed by the corporate investors...there is no need to concede stockholders a return on capital contributed, in effect, either by the taxpayers or by the ratepayers.

James C. Bonbright, Albert L. Danielsen, David R. Kamerschen, Principles of Utility Rates at 288 (1988). See also Martin T. Farris and Roy J. Sampson, Public Utilities: Regulation, Management, and Ownership at 114 (1973) ("This tax deferral is, in effect, an interest free loan to the utility, since depreciation allowances are normally reinvested in the firm").

The Pennsylvania Commission and other state and federal regulatory commissions have recognized this principle as well. For example, in a 1979 West Penn Power rate case involving the Pleasants Unit 1 Generating Station, the Commission addressed the issue of deducting ADIT from rate base as follows:

If this amount is not deducted from rate base, the stockholders will be earning a return on money they never provided...

Under West Penn's proposal, the stockholders would be permitted to retain the tax benefits on which they would earn a return; and the ratepayers would be obligated to provide a return to the stockholders on funds made available by the federal government.

We agree with the consumer advocate, that simple equity to the ratepayers, commission policy regarding treatment of accelerated depreciation benefits, and consistent treatment of such depreciation for both book and rate-making accounts, require that additional deduction in this regard be made to rate base.

Pa. PUC v. West Penn Power Co., 32 PUR4th 245, 264-265, 53 PaPUC 410, 430-31 (1979) (West Penn). The Commission reached the identical conclusion in a case involving the PECO Salem Nuclear Plant. Pa. PUC v. Philadelphia Elec. Co., 31 PUR4th 15 at 44-45, 52 PaPUC 772 at 802-03 (PECO). (The utility's treatment "runs afoul of the well-settled commission principle that tax depreciation benefits must either be flowed through to the benefit of the ratepayer, or if not, then deducted from rate base").

In adopting an adjustment to rate base to reflect ADIT, the Kansas Corporation Commission rejected a utility's argument that there should be no ADIT recognition because it was not addressed in prior orders relating to the underlying amortized operating expense. Western Resources, Inc. v. State Corp. Comm'n of Kan., 30 Kan. App. 2d 348, 365, 42 P.3d 162, 174 (Kan. Ct. of App. 2002). In its decision, which was affirmed by the appellate court, the commission stated:

As Staff indicates, including ADIT in rate base is standard to recognize for ratemaking purposes the cost-free capital provided from ratepayers related to differences between when expenses are deducted for regulatory and income tax purposes. There would be no need to specifically refer to such an adjustment in an Order. Including ADIT in rate base is a well-recognized regulatory accounting concept that is applied in a variety of situations to account for deferred income tax benefits related to rate base assets or for timing differences between when expenses are deductible for income tax purposes and financial reporting purposes.

Id.; see also Florida Progress Corp. v. Commissioner of Internal Revenue, 114 T.C. 587, 589-90, 2000 U.S. Tax Ct. LEXIS 42 (June 30, 2000); aff'd by, Florida Progress Corp. v. Commissioner of Internal Revenue, 2003 U.S. App. LEXIS 21294 (11<sup>th</sup> Cir. 2003). The Florida Public Service Commission (FPSC) and the Federal Energy Regulatory Commission (FERC) recognize ADIT as zero cost capital so that the customers do not pay a return. Specifically:

Customers of Florida Power receive the economic benefit of all deferred income taxes for as long as they are held by Florida Power. The FERC treats deferred income tax as a reduction to the capital rate base used to calculate the approved rate of return on Florida Power's invested capital. The FPSC treats deferred income tax as zero cost capital, meaning that deferred income tax is used to fund services for the benefit of the ratepayers and no return is collected because it was the ratepayers who supplied the capital. Customers get the resulting economic benefit in reduced rates.

Id.

Consistent with standard ratemaking practice, the OCA's position is that ADIT must be recognized in calculating the rate base to which the DSIC pre-tax return rate will apply. The rate base and revenue requirement for DSIC plant additions should be calculated the same way that rate base and revenue requirement are calculated for base rate purposes. It is no more appropriate for ratepayers to pay a return on zero cost capital in rates established between base rate cases than it is in rates established in a base rate case. OCA St. 1 at 4-5. Indeed, as set forth more fully below, utilities with similar DSIC-type mechanisms across the country routinely and

correctly reflect ADIT as an offset to the increased rate base that would otherwise be included in rates. As Mr. Catlin explained:

The DSIC represents an approved exception to the rule against single issue ratemaking that allows the utility to recover the capital-related revenue requirement of specific plant additions that are added to plant in service between rate cases. As an allowed single issue ratemaking item, the calculation of the DSIC rate base and revenue requirement must be consistent with how the rate base and revenue requirement associated with that DSIC-eligible plant would be calculated if that plant was being recovered in a base rate case. In a base rate case, it is recognized that rate base must be reduced to reflect ADIT related to the plant, otherwise ratepayers would be paying the utility a return on funds that were not supplied by investors. The treatment of ADIT in the DSIC should be no different. That is, the DSIC rate base and revenue requirement must be reduced to reflect the balance of ADIT associated with DSIC plant. To do otherwise would allow LWWC to earn a pre-tax return on DSIC investment which is financed with zero-cost capital, not with investor supplied capital.

OCA St. 1 at 5.

Finally, Act 11 was established within Chapter 13 of the Public Utility Code and its requirement that all rates be just and reasonable. 66 Pa. C.S. §§ 1301, et seq. The statute specifies that only costs “incurred” by the utility shall be recovered through the surcharge. 66 Pa. C.S. §§ 1351, 1353. It is, thus, consistent with the language of Act 11 and Section 1301 that the Commission approve a DSIC that is calculated to recover only costs actually incurred by LWWC.

LWWC claimed no allowance for eligible plant additions during the June through August 2013 period for inclusion in its initial DSIC. OCA St. 1 at 5. The OCA recommendation, thus, results in no adjustment to the DSIC rate. The OCA submits, however, that the DSIC formula instituted in this proceeding should establish the correct formula for the calculation of investment on which LWWC is entitled to earn a return.

3. Rates Must Be Calculated Correctly Whether They Are Recovered Through Surcharges or Base Rates.

LWWC witness Kreszswick adopts the position that ADIT is complicated and not necessary because of the earnings cap. LWWC St. 1R at 3-4; LWWC St. 1REJ at 2-3. For the reasons discussed below, the OCA submits that these arguments do not justify approval of a surcharge that will allow the Company to charge ratepayers for a return on non-investor supplied funds.

a. Reflecting ADIT in the DSIC Calculation Is Not Overly Complicated.

LWWC witness Kreszswick argues that the DSIC should be simple and should not include the kinds of complexities addressed in base rate cases. LWWC St. 1R at 3-4, LWWC St. 1REJ at 2-3. The inclusion of ADIT, however, is not overly complex. Rather, it is a necessary correction that is universally accepted as an essential element of just and reasonable rates. The fact is that utilities in Georgia, Kansas, Kentucky, Maine, Maryland (pending), Massachusetts, Missouri, Nebraska, New Jersey, Rhode Island, and Utah calculate ADIT balances associated with incremental investment for their DSIC-type cost recovery mechanisms.<sup>3</sup> OCA St. 1-S at 2. As Mr. Catlin discusses, this demonstrates that recognizing ADIT is not too complicated and is common practice for the calculation of rates that recover infrastructure costs. Id.

Reflecting ADIT for DSIC-eligible plant will not transform the DSIC review process into a full rate case analysis. First, the major element of taxes associated with DSIC property – state and federal income taxes – is already included in the DSIC. Revised Tariff Supp. 85 at

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<sup>3</sup> In re Atlanta Gas Light Co.'s Pipeline Replacement Program, 2009 GAPUC LEXIS 245, \* 10; Kan. Stat. Ann. § 66-2202; Application of Columbia Gas of Ky., Inc. for an Adjustment in Rates, 2009 KYPUC LEXIS 1140, \*49 (Kentucky Order); Ky. Rev. Stat. Ann. § 278.509; CMR 65-407-675; Mo. Rev. Stat. § 393.1009; R.R.S. Neb. § 66-1866; Annual Filing of South Jersey Gas Co. to Adjust its Capital Investment Recovery Tracker, 2011 NJPUC LEXIS 67, \* 35; In re Narragansett Elec. Co. d/b/a National Grid, 2011 RIPUC LEXIS 22, \* 8; In the Matter of the Application of Questar Gas Co. to Increase Distribution Non-Gas Rate and Charges, 2010 UTPUC LEXIS 133, \* 42-43.

10DSIC2; LWWC St. 1S, App. B. Deducting ADIT does not “add” anything more to the calculation, it only serves to correctly and fairly value the rate base on which the utility is entitled to earn a return.

Second, the statute still provides that the surcharge may take effect in as few as 10 days. 66 Pa. C.S. § 1357(d)(3). Third, the adjustments proposed by the OCA will not recognize, *inter alia*, the overall increase in the net plant in the applicable plant categories, offsetting O&M savings associated with incremental investment, and any other offsetting changes that occur between base rate cases. Contrary to the Company’s arguments, recognition of ADIT is consistent with the purpose of the DSIC, which is to permit “timely recovery of the reasonable and prudent costs incurred to repair, improve or replace eligible property.” 66 Pa. C.S. § 1353. Return on the utility’s investment is included as a cost; however, there is no provision for the recovery of costs that are not “incurred” by LWWC because they are funded through taxpayer-supplied ADIT. Id.; see also 66 Pa. C.S. § 1351.

As discussed in Section IV.A.2 above, the DSIC rate, like every rate approved by the Commission must be just and reasonable. In order to comply with the express limitation of Act 11 that costs recovered through the surcharge are incurred by the utility, the DSIC rate base must be adjusted for applicable ADIT.

b. The Earnings Cap Does Not Prevent the DSIC from Being Overstated.

LWWC’s proposed DSIC includes an earnings cap, which determines whether LWWC is allowed to impose a DSIC surcharge. Specifically, it provides:

The charge will also be reset to zero, if, in any quarter, data filed with the Commission in the Company’s then most recent Annual or Quarterly Earnings Report (Schedule D-2, line 14) show that the Company will earn a rate of return that would exceed the allowable rate of return used to calculate its fixed costs under the DSIC as described in the Pre-tax return section.

LWWC St. 1S, App. A at 10DSIC3; 66 Pa. C.S. § 1358(b)(3). LWWC witness Kreszswick adopts the position that the existence of an earnings cap is sufficient to prevent ratepayers from unjust and unreasonable DSIC charges. LWWC St. 1R at 3; LWWC St. 1REJ at 3. The earnings cap will prevent a utility from charging a DSIC when its reported quarterly earnings exceed the rate of return authorized in its last base rate case or in the Commission's Quarterly Earnings Report. 66 Pa. C.S. §§ 1357(b)(2)-(3). Those earnings reports, however, are not subject to the type of review and scrutiny that occur in a rate case and the question of whether or not a utility is "overearning" may be a product of a myriad of factors unrelated to the DSIC. The earnings cap does not prevent utilities from overstating the surcharge revenue requirement and improperly charging ratepayers a return on funds that were not supplied by investors. OCA St. 1-S at 3.

c. Summary.

LWWC has provided no reasonable basis to create a lesser standard of ratemaking for the recovery of capital addition costs through surcharge rates than for the recovery through base rates. Failure to recognize ADIT is not justified by the "complexity" of this calculation (which is being made by numerous other utilities with DSIC-type mechanisms across the Nation) and it is not corrected by the earnings cap. As in the many other states that have addressed this issue, there is simply no question that it is appropriate and necessary to offset the cost of DSIC-eligible plant additions with the accumulated deferred income taxes associated with that plant.

4. Nothing in the Model Tariff or Water Utility Tariffs Approved Prior to Act 11 Limits the Commission's Authority to Correct for ADIT Going Forward.

LWWC witness Kreszswick argues that reflecting ADIT as an offset to rate base is inconsistent with the Final Implementation Order. LWWC St. 1R at 4; LWWC St. 1REJ at 2. As OCA witness Catlin explained, however, recognition of ADIT is necessary to correctly calculate

the surcharge rate base on which utilities can earn a return. OCA St. 1 at 5-6. Mr. Catlin testified:

the DSIC rate base and revenue requirement must be reduced to reflect the balance of ADIT associated with DSIC plant. To do otherwise would allow LWWC to earn a pre-tax return on DSIC investment which is financed with zero-cost capital, not with investor supplied capital.

Id. at 5. The evidentiary record developed in this proceeding demonstrates the need for this correction. Moreover, the corrected calculation recognizes the experience and developments in other states in refining the DSIC formula that was created in Pennsylvania 16 years ago.

The Commission's Final Implementation Order and model tariff were developed based on one working group meeting and two rounds of written comments by interested parties, without the benefit of an evidentiary record. Final Implementation Order at 2-3. This proceeding is one of the Commission's first opportunities to review a proposed DSIC by an investor-owned utility under Act 11 and its first to review a DSIC proposed by a wastewater utility. In its September 12, 2013 Order, the Commission allowed LWWC's DSIC to go into effect but specifically referred issues related to the impact of ADIT associated with DSIC investments for further disposition.<sup>4</sup> Petition of Little Washington Wastewater Co. For Approval of a DSIC, Docket No. P-2013-2366873, Order at 33-34, 43 (Sept. 12, 2013) (September 12 Order). The Commission is not bound to the language of its model tariff; it may choose to modify that language in accordance with its final resolution of this proceeding. This was the case for PGW. There, the Commission approved a final tariff for PGW that differs from the model tariff – even though the model tariff was developed for that one utility specifically. Final Implementation Order at Model Tariff; Petition of Philadelphia Gas Works for Approval of a

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<sup>4</sup> As discussed in the following section, the Commission also referred the calculation of the state income tax component of the DSIC revenue requirement to the OALJ for further disposition. September 12 Order at 33-34, 43.

Distribution System Improvement Charge, Docket No. P-2012-2337737, Order at 10 (May 9, 2013).

As noted, Pennsylvania was the first state to implement a DSIC mechanism for any type of utility. Since that time, however, legislatures, commissions and utilities in at least 11 other states have authorized or implemented infrastructure investment surcharges that deduct ADIT from the surcharge rate base either by statute, regulation, or simply as a routine matter of course. OCA St. 1-S at 2 (Maine and Missouri (water), Georgia, Kansas, Kentucky, Maryland (pending), Massachusetts, Missouri, Nebraska, New Jersey, Rhode Island, and Utah (gas)). In each of those states, ratepayers are protected from paying a return on zero cost capital resulting from ADIT between rate cases, just as they are protected when base rates are set. Id.

Commissions in Maine, Massachusetts, Georgia, Kentucky, New Jersey, Rhode Island and Utah have approved infrastructure investment recovery mechanisms that reflect ADIT in the surcharge calculation without a specific statutory requirement to do so.<sup>5</sup> CMR 65-407-675; In re Atlanta Gas Light Co.'s Pipeline Replacement Program, 2009 GAPUC LEXIS 245, \*10; Kentucky Order at \*49; Annual Filing of South Jersey Gas Co. to Adjust its Capital Investment Recovery Tracker, 2011 NJPUC LEXIS 67, \*35; In re Narragansett Elec. Co. d/b/a National Grid, 2011 RIPUC LEXIS 22, \*8; In the Matter of the Application of Questar Gas Co. to Increase Distribution Non-Gas Rate and Charges, 2010 UTPUC LEXIS 133, \*42-43. Indeed, these ADIT offsets are not even questioned in these decisions; they are treated as a routine matter and taken as a matter of course.

In this proceeding, the Commission has the benefit of an evidentiary record, which demonstrates the need to correctly calculate surcharge revenue requirement and the impact of

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<sup>5</sup> Other states have incorporated recognition of accumulated deferred income taxes in statutes implementing DSIC-type mechanisms. Mo. Rev. Stat. § 393.1009; Kan. Stat. Ann. § 66-2202; R.R.S. Neb. §§66-1866.

ADIT on ratepayers, as well as the collective experience of other states that have implemented a DSIC-type mechanism, to ensure that the DSIC established for LWWC does not permit the Company to charge ratepayers a return on non-utility supplied investment.

LWWC witness Kreszwick also supports the proposition that because the water industry uses no ADIT offset then no such offset should be recognized for the purposes of implementing Act 11. LWWC St. 1REJ at 3. It is important to recognize, however, that Act 11 specifies that Commission rules and orders relating to DSICs established prior to Act 11 remain in effect only for the water utilities, while also giving the Commission authority to amend or revoke the orders. See 66 Pa. C.S. § 1358(a)(2). Specifically, Section 1358(a)(2) states:

All proceedings, orders and other actions of the commission related to a distribution system improvement charge granted to a water utility and all practices and procedures of a water utility operating under a distribution system improvement charge prior to the effective date of this paragraph shall remain in effect unless specifically amended or revoked by the commission.

66 Pa. C.S. § 1358(a)(2). Section 1358(a)(2) clearly shows that the General Assembly did not intend for the Commission's existing DSIC rules and procedures for the water companies to automatically apply to electric distribution companies, natural gas distribution companies, city natural gas operations or wastewater companies

##### 5. Conclusion.

The DSIC is intended to be an exception to the prohibition against single-issue ratemaking; however, that single issue must be calculated fairly and correctly. To make the DSIC calculation correct (to allow recovery only for costs actually incurred by the utility), the rate base on which the pretax return is calculated must reflect an offset for accumulated deferred income taxes. If the balance of ADIT is not recognized, LWWC will be allowed to earn a return on DSIC plant by incorrectly assuming that all of that plant was paid for with investor supplied capital when, in fact, it was partially paid for with zero cost capital in the form of deferred taxes.

The calculation of investment on which LWWC is entitled to earn a return for DSIC purposes should be the same as how the balance would be calculated for purposes of base rates. That is, the eligible balance should equal plant less accumulated depreciation on that plant less ADIT associated with that plant.

B. State Income Taxes.

The OCA has also identified a correction that must be made to LWWC's calculation of state income taxes in the DSIC revenue requirement determination. The Company developed its pre-tax rate of return by grossing up the equity component of its overall return to account for both state and federal income taxes at the full statutory rates. LWWC St. 1S, App. A at 10DSIC1; OCA St. 1 at 6. The amount of state income taxes that LWWC will pay on DSIC revenues, however, will be affected by tax deductions related to the DSIC investment, in particular the accelerated depreciation and, when applicable, bonus depreciation. OCA St. 1 at 6-7. Because LWWC will not pay state income taxes on the full amount of its equity return, these deductions should be taken into account in determining state taxable income and state income tax expense. The state income tax rate used to calculate DSIC revenue requirement should reflect the state income tax expense actually paid.

With respect to state income tax deductions in Pennsylvania, the law is clear. That is, state income tax deductions must be reflected in rates on a current basis, consistent with the "actual taxes paid" doctrine. Id. at 8. The Pennsylvania Superior Court addressed this principle:

The commission in 1932 very properly held that the utility was not entitled to an allowance on account of a tax which it had not been called upon to pay and which there was then no evidence that it would be required to pay. Our statement is applicable to the present situation, where the utility has not been called upon to pay the tax which it saved by reason of the use of accelerated depreciation, and where there is no evidence that it will ever be called upon to do so within the reasonably foreseeable future.

Pittsburgh v. Pa. PUC, 182 Pa. Super. 551, 577-579, 128 A.2d 372, 384 (1956) (Pittsburgh I).

The Pennsylvania Supreme Court rendered the seminal decision regarding the flow-through of income tax benefits in Barasch v. Pa. PUC, where it determined that the Commission could only find rates “just and reasonable” if those rates are based on the actual taxes paid. 507 Pa. 496, 521, 491 A.2d 94, 107 (1985) (Penn Power). While the Court recognized that federal “normalization” rules prohibited the immediate flow-through of federal tax benefits, the Court required the utility to flow through state income tax benefits to ratepayers on a current basis.

Penn Power, 507 Pa. at 504-05, 518, 520-22, 491 A.2d at 98, 101, 105-107. It held:

We believe that the Pennsylvania version of the “actual taxes paid” doctrine, as developed in Pittsburgh I and II and the Commission in its earlier cases, accurately interprets the statutory requirement and rates be “just and reasonable,” found in 66 Pa. C.S. § 1301.

Id. at 521-22, 491 A.2d at 107; see also Barasch v. Pa. PUC, 507 Pa. 561, 493 A.2d 653 (1985). (UGI) (when the PUC approves hypothetical expenses not actually incurred, it commits an error of law); Popowsky v. Pa. PUC, 695 A.2d 448, 455 (Pa. Commw. Ct. 1997).

Consistent with Penn Power, this Commission has recognized that flow-through of the benefits associated with utilizing accelerated depreciation in the calculation of state income taxes is “mandated.” Pa. PUC v. Metropolitan Edison Co., 60 PaPUC 349, 398 (1985). Moreover, as stated by the Commission:

[UGI] stands for the proposition that the Commission does not have the authority to permit the inclusion of hypothetical expenses not incurred, and more specifically, establishes the “actual taxes paid” doctrine, prohibiting a utility from collecting “phantom taxes.”

Pa. PUC v. Jackson Sewer Corp., 2001 PaPUC LEXIS 53, \* 47 (citing UGI) (Jackson Sewer).

In base rate cases, LWWC correctly flows through the state income tax benefits of accelerated depreciation and bonus depreciation. OCA St. 1 at 7. The OCA submits, however,

that as a matter of Pennsylvania law, the Company must calculate the state income tax revenue requirement for the DSIC plant additions in the same manner. Id. It is no more lawful or appropriate for ratepayers to pay phantom state income taxes in rates established between base rate cases than it is in rates established in a base rate case. The requirement of just and reasonable rates applies to *every* rate approved by the Commission. 66 Pa. C.S. § 1301. Reflecting actual state income taxes paid in the DSIC is also consistent with Act 11, which limits recovery to costs incurred by the Company. 66 Pa. C.S. §§ 1351, 1353(a).

LWWC witness Kreszswick argues that the Commission's Final Implementation Order supports the use of statutory tax rates, federal and state, in calculating the pre-tax return for the DSIC. LWWC St. 1R at 4-5; LWWC St. 1REJ at 2. In response, the OCA submits that the language of the Act itself, which explicitly limits DSIC recovery to costs actually incurred by the utility, tends to preclude the use of taxes that were not actually "incurred". 66 Pa. C.S. §§ 1351, 1353. Further, it must be presumed that the General Assembly intended for DSICs established pursuant to Act 11 to comply with the existing requirement of Section 1301 that every rate – whether established in a Section 1308 base rate proceeding or a Section 1350 surcharge – must be just and reasonable. 66 Pa. C.S. §§ 1301, 1308, 1353; Northern Tier, 860 A. 2d 1173 ("statutes are to be construed in harmony with the existing law and as part of a general and uniform system of jurisprudence"). The Pennsylvania Supreme Court has determined that just and reasonable rates must reflect the actual taxes paid and, conversely, that rates that do not reflect the actual taxes paid cannot be just and reasonable for purposes of Section 1301. Penn Power, 507 Pa. at 521, 491 A.2d at 107.

Further, LWWC's reliance on the discussion cited in the Commission's Final Implementation Order is misplaced. LWWC St. 1R at 4. The Order does not address the issue,

however, and the model tariff does not specify that the statutory rate be applied without adjustment for the effective tax rate. Final Implementation Order, App. A. Consistent with the Commission's holding in Jackson Sewer, appellate law and Act 11's requirement that the DSIC recover only costs incurred, rates cannot include phantom taxes. Where a utility is not paying the full statutory tax rate on DSIC income, it must make an adjustment to properly reflect the effective tax rate as part of its calculation of the gross-up for pre-tax return. OCA St. 1 at 6-7; see Jackson Sewer at 47; Penn Power; UGI; 66 Pa. C.S. §§ 1351, 1353. While LWWC argues that it would be easier not to calculate a utility-specific tax rate (LWWC St. 1R at 4), that is not the purpose of Act 11. The stated purpose of the charge authorized by Act 11 is to provide an alternative to base rate filings that will provide for timely recovery of eligible costs "incurred" by the utility. 66 Pa. C.S. §§ 1351, 1353(a).

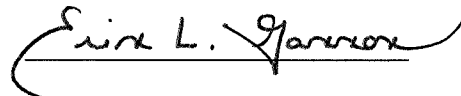
In summary, the Commonwealth's highest court has held that no rate is just and reasonable if it does not reflect the actual taxes paid by the utility. Act 11 also imposes the requirement that fixed costs, which include pre-tax return, recovered through the DSIC must have been "incurred" by the utility. LWWC's state income tax expense for DSIC revenues will be affected by applicable tax deductions for accelerated depreciation and bonus depreciation related to the DSIC investment. To make the DSIC calculation correct (and to allow recovery only for costs actually incurred by the utility), LWWC's pre-tax rate of return must recognize the flow-through of state income tax deductions associated with the investments that are recovered through the DSIC.

## V. CONCLUSION

For the reasons set forth in this Main Brief, Little Washington Wastewater Company's proposed initial DSIC tariff must be revised. The Company should be directed to change its tariff and DSIC calculation consistent with the OCA's recommendations and refund any excess revenues charged due to the gross-up of the pre-tax rate of return at the full state income tax rate and the failure to deduct ADIT from rate base.

In addition, the OCA respectfully submits that the proposed Joint Stipulation Addressing Application of Distribution System Improvement Charge to Contract Customers and Woodloch Pines be approved.

Respectfully submitted,



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DATED: March 11, 2014

178334

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Little Washington Wastewater Co. :  
For Approval of a Distribution System : Docket Nos. P-2013-2366873  
Improvement Charge : C-2013-2369886

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Proposed Findings of Fact, Conclusions of Law and Ordering Paragraphs

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Proposed Findings of Fact

*Jurisdiction*

1. The OCA's Formal Complaint, docketed at C-2013-2369886, was filed against a proposed rate.

*ADIT*

2. In its September 12 Order, the Commission allowed LWWC's DSIC to go into effect but specifically referred issues related to the impact of the Accumulated Deferred Income Taxes (ADIT) associated with DSIC investments "for further disposition." September 12 Order at 33-34.

3. ADIT balances are generated by the difference between federal taxes actually paid by the Company and the federal taxes it recorded for ratemaking. OCA St. 1 at 4-5. Under Commission ratemaking practice, ADIT is reflected as an offset to rate base in determining the revenue requirement. Id. at 5. ADIT represents a source of zero cost capital to the utility. Id.

4. The rate base formula in LWWC's initial DSIC tariff does not recognize the balance of ADIT associated with DSIC-eligible plant as an offset to DSIC rate base. Id. at 4-5.

5. LWWC's proposed calculation can overstate the DSIC investment balance and allow LWWC to earn a return on funds that were not invested by shareholders. OCA St. 1 at 4-5.

6. LWWC did not claim any allowance for DSIC-eligible plant additions during the June through August 2013 period. OCA St. 1 at 5.

7. The model tariff and the Commission's Final Implementation Order were developed based on one working group meeting and two rounds of written comments by interested parties, without the benefit of an evidentiary record. Final Implementation Order at 2-3.

8. Other commissions have also approved infrastructure investment recovery mechanisms that reflect ADIT in the surcharge calculation without a specific statutory requirement. LWWC St. 1S, App. A at 10DSIC1; OCA St. 1-S at 2; Western Resources, Inc. v. State Corp. Comm'n of Kan., 30 Kan. App. 2d 348, 42 P.3d 162 (Kan. Ct. of App. 2002); Florida Progress Corp. v. Commissioner of Internal Revenue, 114 T.C. 587, 2000 U.S. Tax Ct. LEXIS 42 (June 30, 2000), aff'd by, Florida Progress Corp. v. Commissioner of Internal Revenue, 2003 U.S. App. LEXIS 21294 (11<sup>th</sup> Cir. 2003). See also CMR 65-407-675; In re Atlanta Gas Light Co.'s Pipeline Replacement Program, 2009 GAPUC LEXIS 245, \*10; Annual Filing of South Jersey Gas Company to Adjust its Capital Investment Recovery Tracker, 2011 NJPUC LEXIS 67, \*35; In re Narragansett Elec. Co. d/b/a National Grid, 2011 RIPUC LEXIS 22, \*8; In the Matter of the Application of Questar Gas Company to Increase Distribution Non-Gas Rate and Charges, 2010 UTPUC LEXIS 133, \*42-43.

9. The earnings cap does not prevent utilities from overstating the surcharge revenue requirement and improperly charging ratepayers a return on funds that were not supplied by investors. OCA St. 1-S at 3.

10. Act 11 specifies that only costs “incurred” by the utility shall be recovered through the DSIC. 66 Pa. C.S. §§ 1351, 1353.

11. Act 11 specifies that Commission rules and orders relating to DSICs established prior to Act 11 remain in effect only for the water utilities, while also giving the Commission authority to amend or revoke the orders. 66 Pa. C.S. § 1358(a)(2).

*State Taxes*

12. The Company developed its pre-tax return by grossing up the equity component of its overall return to account for both state and federal income taxes at the full statutory rates. OCA St. 1 at 6.

13. State income tax deductions must be reflected in rates on a current basis, consistent with the “actual taxes paid” doctrine. OCA St. 1 at 8.

14. Reflecting actual state income taxes paid in the DSIC is consistent with Act 11, which limits recovery to costs “incurred” by the Company. 66 Pa. C.S. §§ 1351, 1353(a).

Proposed Conclusions of Law

*Jurisdiction*

1. The Commission has jurisdiction over the subject matter of and the parties to this proceeding. 66 Pa. C.S. § 1102 (a)(2), 1103(a).

*Burden of Proof*

2. Section 332(a) of the Public Utility Code provides that the proponent of a rule or order from the Commission has the burden of proof. 66 Pa. C.S. § 332(a).

3. LWWC has not met its burden of proving that its DSIC rate is calculated to produce just and reasonable rates pursuant to Chapter 13. 66 Pa. C.S. § 1301.

4. LWWC has not met its burden of proving that its failure to offset rate base with ADIT related to the DSIC-eligible plant to correctly calculate the DSIC rate base on which it is entitled to earn a return produces just and reasonable rates, meets the requirement of Act 11 that the DSIC recover costs incurred by the utility, or complies with longstanding precedent in Pennsylvania and nationwide that ratepayers should not pay a return on funds that were not supplied by investors. 66 Pa. C.S. §§ 1301, 1350 et seq.; Pa. PUC v. West Penn Power Co., 32 PUR4th 245, 53 PaPUC 410 (1979); Pa. PUC v. Philadelphia Elec. Co., 31 PUR4th 15, 52 PaPUC 772 (1978).

5. LWWC has not met its burden of proving that its failure to reflect actual state taxes paid in determining DSIC revenue requirement is consistent with the actual taxes paid doctrine and the requirement of Act 11 that the DSIC recover costs incurred by the utility. 66 Pa. C.S. §§ 1031, 1350 et seq.; Barasch v. Pa. PUC, 507 Pa. 496, 491 A.2d 94 (1985).

Proposed Ordering Paragraphs

IT IS HEREBY ORDERED THAT:

1. LWWC is directed to modify its tariff, containing the revised language below, to be effective on ten days' notice:

DSI=Original cost of eligible distribution system improvement projects net of accrued depreciation and accumulated deferred income taxes.

2. LWWC is directed to modify its pre-tax rate of return in the DSIC calculation to recognize the flow-through of state income tax benefits associated with the investments that are recovered through the DSIC. Revenues collected pursuant to its DSIC tariff will be refunded based on the Commission's resolution in this Order.

3. The proposed Joint Stipulation Addressing Application of Distribution System Improvement Charge to Contract Customers and Woodloch Pines is approved.

4. The Complaint of the Office of Consumer Advocate is sustained.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Little Washington Wastewater Co. :  
For Approval of a Distribution System : Docket Nos. P-2013-2366873  
Improvement Charge : C-2013-2369886

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Testimony  
of the  
Office of Consumer Advocate

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1. OCA Statement No. 1 – Direct Testimony of Thomas S. Catlin dated November 21, 2013 (admitted into the record on February 11, 2014).
2. OCA Statement No. 1-S – Surrebuttal Testimony of Thomas S. Catlin dated January 21, 2014 (admitted into the record on February 11, 2014).

CERTIFICATE OF SERVICE

Re: Petition of Little Washington Wastewater Company  
For Approval of a Distribution System Improvement Charge  
Docket No. P-2013-2366873

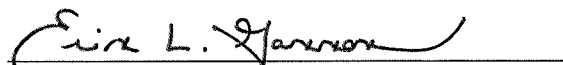
I hereby certify that I have this day served a true copy of the foregoing Main Brief of the Office of Consumer Advocate upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 11th day of March 2014.

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